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Aritzia, Inc. (ATZ.CA)

Q3 2020 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Thank you for standing by. This is the conference operator. Welcome to Aritzia's Third Quarter 2020 Earnings Conference Call. As a reminder, all participants are in listen-only mode and the conference is being recorded. After the presentation, there will be an opportunity to ask questions. [Operator Instructions]

I would now like to turn the conference over to Helen Kelly, Vice President of Investor Relations. Please go ahead.

Helen Kelly

Vice President-Investor Relations, Aritzia, Inc.

Thank you, Ariel, and thank you, all, for joining us for Aritzia's third quarter 2020 earnings conference call. With us today are Brian Hill, Founder, CEO, and Chairman; Jennifer Wong, our President and Chief Operating Officer; and Todd Ingledew, our Chief Financial Officer. We will begin today's call with management's discussion, followed by a question-and-answer period open to analysts and investors.

Please note that remarks on this conference call may provide information regarding our expectations, future plans, and intentions that may constitute forward-looking statements. We would refer you to our most recently filed management's discussion and analysis, which includes a summary of the material assumptions, as well as certain material risks and factors that could affect our future performance and our ability to deliver on these forward-looking statements.

The third quarter 2020 earnings release, the related financial statements, and the MD&A are available on SEDAR, as well as the Investor Relations section of our website at aritzia.com. Finally, all figures discussed on this conference call are in Canadian dollars, unless otherwise noted.

I will now turn the call over to Brian.

Brian Hill

Founder, Chief Executive Officer & Chairman, Aritzia, Inc.

Thank you, Helen, and thank you for joining us this morning. Happy New Year. I hope everybody enjoyed the holidays. As 2019 draws to a close, we celebrate another decade that has seen exceptional growth for our company. I am proud of the results we continue to accomplish year after year, and I'd like to thank the entire Aritzia team across our boutiques, concierge, distribution centers and support offices for their hard work towards a great third quarter and a strong start to the holiday season.

We ended the third quarter with a strong November and a best Black Friday event to date. Despite slightly lower markdowns, we are pleased that sales continued to trend higher since we embraced the introduction of our Black Friday in Canada five years ago. Accompanied by a record surge in eCommerce penetration and notably stronger revenue contribution from the United States, the week of Black Friday now represents our single biggest week of the year.

Overall, revenue in the quarter grew 10% from last year and we delivered a comparable sales increase of 5.1%, marking our 21st consecutive quarter of positive comparable sales growth. This comes on the back of double digit increases last year, resulting in a two-year comp stack of 18%. These results reflect meaningful contribution from our new and repositioned boutiques and the ongoing momentum in eCommerce.

As noted last quarter, our accelerating US eCommerce channel continues to read our growth. Driving sales in the third quarter with our expanded fall and winter outerwear offering, in addition, to our signature parkas and beautiful wool coats, our puffers performed exceedingly well and generated significant attention online in on social media.

We made a first foray in the men's with Mr. Super Puff in late October. While we are optimistic with the initial order, sales have far exceeded our expectations to the point we have, for all intents and purposes, sold out. Given the strong sales performance and positive client responses we have received, we'll continue to build out our men's puffer assortment next fall although it's premature to predict at this point whether we will expand further in the men's wear.

The team also did an excellent job with our holiday collection in the third quarter. We launched our second collection of TEN by Babaton, comprised of sleek evening wear and form fitting silhouettes, we are pleased with the success of the brand to date and are excited about its sales potential as we build on the collection and future seasons.

Shifting to channels, strong double-digit revenue growth and eCommerce continued into the third quarter supported by marked growth in both online traffic and number of transactions, particularly, in the United States. Overall, we're confident that eCommerce would be a significant driver of our growth going forward. At the same time, boutique expansion remain an essential component of our strategy. Our boutiques have proven to be powerful tools in building brand awareness, drawing new customers to Aritzia and delivering consistent revenue and earnings growth.

During the third quarter, we opened a boutique in Cherry Creek, Denver, and completed the repositions of Rideau, Ottawa and Coquitlam Center, Vancouver. Payback on our investments in new boutique continues to accelerate and we're thrilled with the strong reception to the brand, both in boutiques and online as we enter these new markets.

We attribute our growing brand awareness, in part, to the success we have seen in our marketing efforts to-date. Our list of paid and unpaid influencers continues to grow to reflect highly relevant celebrities and personalities. We had notable earned media hits in the quarter, including publications in Forbes and people, as well as other significant influencer posts to propel our brand, particularly, in the United States.

Finally, we continue to make important investments across technology, infrastructure and talent to propel our growth. We completed our first milestones for the Customer 360 project during the quarter and launched our new marketing communications platform just in time for Black Friday. These exciting developments build on our world-class infrastructure and are expected to drive meaningful revenue opportunities.

We are confident that our partnership with SAP and our ability to leverage best-in-class systems for advanced data and analytics position us well for the growth ahead. Jennifer will elaborate on these in a moment.

Overall, we are pleased with our performance this quarter and the continued strength in both our accelerating eCommerce business and our success in the United States. Before discussing our business outlook, I will turn the call to Jennifer, who will give you an update on our operational investments in detail. Following our comments, Todd will provide key highlights of our third quarter financial results.

I will now turn the call over to you, Jennifer.

Jennifer Wong

President, Chief Operating Officer, Corporate Secretary & Director, Aritzia, Inc.

Thank you, Brian, and good morning, everyone. From the launch of the Customer Program and our PLM implementation to the talent we are seeking to add to our incredible team, we are continuing to invest in technology and people to support our long-term growth objectives. I am pleased to give you an update on where we are today beginning with our Customer Program.

With the launch of Customer 360 in November, we successfully migrated our central customer data repository to a new cloud-based system, containing dozens of client attributes. The new repository facilitates the flow of information across our front-facing system to give us an enhanced view of our clients in real time. This milestone achievement is the foundation for the other three pillars of our Customer Program.

I am also proud of the effort the team put into the completion of the first phase of the Marketing Communications Platform, which we used to send our Black Friday and holiday emails. Leveraging the data from Customer 360, the Marketing Communications Platform is a powerful engine that will enable us to generate and personalize marketing campaigns based on the preferences of each of our clients, while ensuring a consistent omni-channel experience.

For example, for the client who's a dedicated Babaton shopper, we will be able to tailor specific communications regarding new Babaton collection. Alternatively, if we open in a brand new market, we can identify and invite clients who live in the area to check out our new boutique. Without this tool, this type of outreach would be a very high effort and now, we will be able to personalize e-mails for our clients with the click of a few buttons. Needless to say, we are excited to roll out the second phase with enhanced campaign capability in the coming months.

Looking forward, we are excited about what is to come in fiscal 2021 with regards to the launch of the remaining projects within our Customer Program. Responsible for over 1.3 million interactions annually with our clients, Concierge represents a revenue-generating opportunity. In addition to replacing our old case management system that oversees client support through the lifecycle of their purchases, we are also looking forward to the added capability for multiple communication channels with our clients in the future, including email, live chat, text or phone. We have just started testing and expect to have the first phase of Concierge completed by the first quarter of fiscal 2021.

Lastly, the cornerstone of the Customer Program is the digital selling tool. In the form of a mobile app, the tool will further empower our style advisors and elevate the client's retail experience. This digital black book will provide our style advisors with a wealth of information on client preference and purchase history and enable personalized one-on-one communications, appointment scheduling and inventory look-up capability. We are near completion of the planning phase and are targeting Phase 1 to go live in the second quarter.

All in all, we are thrilled with the progress we are making on each of the projects within our Customer Program. We are aiming to delight our clients by providing a seamless, consistent and personalized approach towards how we engage and service their needs.

Turning now to our product lifecycle management system. We continue to advance this foundational technology, which provides visibility to the materials and processes that enable bringing our products to market. We are on track for Phase 1 in the first quarter. We are excited about the opportunities with PLM from product innovation to supporting sustainability to streamlining our operations.

Finally, we continue to invest in talent across our business to support our growth. During the quarter, we added key leadership positions across eCommerce, supply chain logistics and retail management in the US. And we will continue to build on the incredible breadth and depth of talent across the Aritzia team in the coming year. I am confident our best years lie ahead of us and it is our team of remarkable individuals, who allow us to set our sights on new opportunities and continued success.

I will now turn the call over to Todd to discuss our financial results and our outlook for the fiscal year.

Todd Ingledew

Chief Financial Officer, Aritzia, Inc.

Thank you, Jennifer, and good morning, everyone. We are pleased with our results in the third quarter and encouraged by the momentum leading into Q4. As a reminder, we began reporting under IFRS 16 renewed leasing standard in the first quarter of our fiscal 2020. The net impact of IFRS 16 in the third quarter was a reduction of only CAD 16,000 to net income. We do not expect the standard to have a material impact on net income in the fourth quarter.

In my review of our financial results, I will focus my commentary on the comparative figures, which exclude the impact of IFRS 16.

Turning to our results, net revenue grew 10% to CAD 267.3 million in the third quarter. This was driven by strength in our e-commerce business, three new and four reposition boutiques which opened since the end of the third quarter last year as well as comparable sales growth in our boutiques. Our annual warehouse sale shifted to the second quarter of this year from the third quarter last year, negatively impacting third quarter net revenue growth in the low single digits. For the third quarter, we delivered a 5.1% comparable sales increase.

While warmer weather contributed to a slower start, growth accelerated in the back half of the quarter and we ended the period with a record Black Friday. These results saw a 12.9% increase in the third quarter of last year, resulting in a two-year stacked comp of 18%.

Our e-commerce business continues to lead comp sales growth. Our new boutiques are performing above expectations and are exceeding our targeted payback periods. Gross profit margin excluding the impact of IFRS 16 was 42.6%, down 50 basis points. We benefited from the shift in our warehouse sale in addition to improvements from our sourcing initiatives and leverage on occupancy costs. However, these benefits were offset by higher distribution center costs, as we proactively ramped up staffing earlier for the holiday, continued headwinds from the Canadian dollar, US tariffs as well as ongoing higher raw material costs.

SG&A expenses, excluding the impact of IFRS 16, increased by 13.4% to CAD 64.1 million. SG&A expenses were 24% of net revenue, compared to 23.3% last year. SG&A expenses in the quarter included CAD 2.5 million of investments in our Customer Program. Excluding these investments, SG&A as a percentage of revenue was 30 basis points better than last year.

Adjusted EBITDA, excluding the impact of IFRS 16, increased by 2.4% to CAD 58.4 million, or 21.9% of net revenue, compared to 23.5% last year. Adjusted EBITDA was impacted by the CAD 2.5 million investments in our Customer Program, as well as the CAD 1.8 million reduction in other income year-over-year. Adjusted net income was effectively flat at CAD 35.7 million. Adjusted net income per diluted share increased to CAD 0.32 from CAD 0.31 in the third quarter last year.

Our balance sheet remains exceptionally strong with a cash balance of CAD 95.7 million, with zero drawn on our revolving credit facility at the end of the quarter, which puts us back in a positive net debt position. This compares to a cash balance of CAD 123 million at the end of the third quarter last year. The primary use of our cash flow from operations in the third quarter last year was both the CAD 107 million share repurchase as well as the CAD 39.4 million of capital investments. We also ended the third quarter in a strong inventory position. Inventory was up 15.5% for the third quarter last year in line with the growth of our business.

Turning to our outlook. We are particularly pleased that the sales momentum from the end of the third quarter has continued into the fourth quarter. We expect positive comparable sales growth in the high single-digits in the fourth quarter. For the full year fiscal 2020, we continue to expect net revenue growth in the low double-digits.

Removing revenue from the additional week in fiscal 2019, net revenue in fiscal 2020 is expected to grow in the low to mid-teens. Including the two store openings planned for the fourth quarter, we remain on track to open five new boutiques, all in the United States this year. Our outlook for gross profit margin remains flat to slightly lower than fiscal 2019 due to ongoing higher raw material costs and the impact of increased tariffs on goods coming from China.

We continue to expect SG&A to grow faster than revenue in fiscal 2020 as we make strategic investments in technology and infrastructure. These investments are predominantly cloud based and are expensed. Incremental SG&A expenses related to these initiatives in the fourth quarter are expected to be CAD 2 million to CAD 3 million with total project spend for the year to be approximately CAD 7 million to CAD 8 million.

We reduced our expected net capital expenditures to \$40 million to \$45 million, including costs related to new and reposition boutiques in addition to infrastructure investments. The reduction in expenditure for the year are primarily related to timing of infrastructure projects.

In closing, we are pleased with the momentum that carried into the fourth quarter and we remain confident about the outlook for our business. Our strong performance and solid balance sheet keeps us firmly on track to meet or exceed our stated 2021 financial targets and positions us to deliver on our future growth.

With that, I will now turn it back to Brian to discuss our business outlook.

Brian Hill

Founder, Chief Executive Officer & Chairman, Aritzia, Inc.

Thanks, Todd. As we head into 2020, we remain focused on the development of beautiful high-quality products from fabric to fit. The unique personalized service we offer our clients, our aspirational shopping environments, captivating communications and, of course, the people who support these client interactions. They all touch our brand and collectively they are ingredients of everyday luxury. In an industry where no detail is too small, each decision we make thoughtfully contributes to our unique positioning. I truly believe our ability to delight our clients on all these fronts will continue to set us apart.

Looking into the fourth quarter, the sales momentum from the back half of the third quarter continued through the holiday season and the start of the fall/winter sale. We are pleased with the balance assortment in our product offering and I feel we are well-positioned with our inventory to capitalize on the revenue opportunities for the balance of the season.

Longer term, we continue to evaluate our opportunities in both product categories and brand expansions. We are progressing with our work on warm weather strategy, as well as an extended sizing initiative that we expect to launch this spring/summer. Shifting again to our channels, our e-commerce business remains a top priority. We are encouraged by acceleration of our e-commerce business and continue to invest in marketing, infrastructure and talent to capitalize on these opportunities.

In the near-term, we are advancing a number of initiatives to enhance and personalize our clients' online experience, including the addition of a fit model to better assist her in size selection. In fiscal 2021, we will continue with site optimizations, improve our international site and expand our omni-channel fulfillment capability by putting in place a centralized view of our inventory and enable cross channel fulfillment such as buy online, fulfill in store.

We expect e-commerce to drive an ever increasing component of our top line growth. Augmenting our online growth is our premier real estate portfolio. I think it's fair to say we have never been in a better position as we are now with regard to the pipeline of opportunities in front of us. We have access to some of the best real estate available with increasingly attractive financial terms.

We're on track to open two new locations in the fourth quarter, the Houston Galleria, and the Domain in Austin, Texas. Both are located in Texas and represent new markets for Aritzia. While we are still finalizing our pipeline for fiscal 2021, our plans include locations such as American Dream in New Jersey which is already complete and waiting for the center opening, King of Prussia in Philadelphia and finally, deeper question to Los Angeles. As I've said before, our boutiques are the number one driver of brand awareness, particularly, as we expand into the United States. Our intention is to accelerate the cadence of new boutique openings going forward. However, we will not compromise site selection or sacrifice our business requirements.

In conclusion, we are extremely pleased with yet another strong quarter and the sustained momentum in our business as we drive growth across products, channels and marketing. With investments in infrastructure to

enable that growth, we remain on track to meet or exceed the growth and profitability targets we set out ourselves five years ago and we look forward to sharing with you our version for the next three years in the upcoming months.

With that, we'll now welcome questions. I turn the call back to the operator.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question comes from Mark Altschwager of Baird.

Mark R. Altschwager

Analyst, Robert W. Baird & Co., Inc.

Q

Good morning. Happy New Year, and congrats on the continued momentum. My first question, just with respect to the revenue performance in the third quarter, I'm curious how the later Thanksgiving holiday may have impacted the growth in the third quarter versus what you're expecting in the fourth quarter?

Brian Hill

Founder, Chief Executive Officer & Chairman, Aritzia, Inc.

A

Todd, do you want me to take this?

Todd Ingledew

Chief Financial Officer, Aritzia, Inc.

A

Sure.

Brian Hill

Founder, Chief Executive Officer & Chairman, Aritzia, Inc.

A

I mean, the weather was warm earlier in the third quarter, and I think we felt that a little bit and then at least as the weather got a little colder, our sales picked up meaningfully. We had an extremely good holiday period, the start of the holiday period at the end of the quarter. And those are big numbers and we're comping – it's our busiest week of the year and we've always found that it's harder to comp on the big weeks than it is on more typical weeks, but the momentum played well and stayed strong right through the start of the remainder of the holiday season in [ph] P-TEN (00:23:31). I don't know if that answered your question?

Mark R. Altschwager

Analyst, Robert W. Baird & Co., Inc.

Q

Great. Yeah. It does. It's helpful. And then also on the holiday strategy, it appears, if there's any change in your sales strategy, it looks like you may have actually had a slightly shorter sale around the Black Friday period, but maybe confirm it if that's right or not and any implications on merchandise margin there. And then just looking ahead, I know you're reaffirming the gross margin guidance for the full year that leaves open a pretty wide range of outcomes for the fourth quarter. So just curious, if you get a little bit more specific on how you're thinking about that gross margin trajectory in the fourth quarter relative to the third quarter?

Brian Hill

Founder, Chief Executive Officer & Chairman, Aritzia, Inc.

A

So, I'll take the first two parts of that and Todd will take the third part of that. Our strategy we put in place probably about three or four years ago, when we recognized it, particularly, in Canada that the Black Friday was going to be a meaningful sales driver. So, for the last few years what we've done is just really tweaked it a little bit and we've aligned it a little bit more with the United States, obviously, because they have actual holiday on the Thursday and we don't in Canada. There's some slight variances between the two countries but generally, we're trying to align that.

We're trying to align our business in general. When we first moved in the United States, we spent quite a bit of time analyzing the market. We tried to have our various sales strategies and merchandising strategies and launch strategies reflect the market in United States [indiscernible] (00:25:09) different in Canada. But we've found these have converged quite a bit, and so we're making an effort to align as much as we possibly can.

As far as the period went, so nothing really notably changed as far as the sale period. We weren't quite as deep with our markdowns this season. There's several reasons that went into that, but we didn't go quite as deep and it turned out to be a great strategy for us. It's not that meaningful, but it was certainly a little bit of a switch for us.

Todd Ingledew

Chief Financial Officer, Aritzia, Inc.

A

Great. Yeah. Mark, for the fourth quarter, we expect to continue to see pressure from ongoing raw material price increases, as well as slightly elevated pressure from the new US tariffs on goods coming in from China, just as more of our inventory that we're selling in Q4 has come in since the tariff has been in place. So we do expect to continue to see pressure that will be similar to what we saw in Q3.

Brian Hill

Founder, Chief Executive Officer & Chairman, Aritzia, Inc.

A

And can I add something to that, as we continue to aspire for everyday luxury, we're making decisions on our product development as well that we think elevates our product and whether that be [ph] trims (00:26:39) or fabrications or construction and selling and things like that. So a little bit of the pressure, Todd speaking of, is a little self-inflicted as we continue to elevate our product for our customers and try to delight them more and more.

Mark R. Altschwager

Analyst, Robert W. Baird & Co., Inc.

Q

Thank you for all that detail. And maybe one last one, Brian, it sounds like we're going to be hearing more in the coming months on a refreshed three-year plan, but any high level thoughts you're able to share today just in terms of how you're thinking about the revenue growth and EBITDA margin trajectory for fiscal 2021?

Brian Hill

Founder, Chief Executive Officer & Chairman, Aritzia, Inc.

A

Jennifer is going to share that and right now, the numbers are quite [indiscernible] (00:27:19), so I'm not really prepared to share the numbers specifically with you. As I mentioned, we're going to look at increasing the cadence of the new boutique openings. I know we have a few more repositioned this year than we had originally planned as well. But we just – our business continues to accelerate in the United States and our eCommerce continues to outperform from where we had initially planned.

So we're really going to focus on those two areas for the three-year plan is really driving our US business. We're still grossly undersized to our Canadian business and our customers seem to love our product there and in the

services and everything else that our teams offer. And so, we're going to continue to drive that. And then [indiscernible] (00:28:06) continues to exceed our expectation.

And obviously, the landscape is changing for everybody, but we seem to be – our pace of expansion in eCommerce seems to continue to surprise and delight us as well. So we're going to be – it's going to be a big focus in both those areas, United States and eCommerce growth. And of course, we have an incredible base of business in Canada. We're not going to forget that, that's what we've built the organization on. And we're still industry leaders here in Canada and hope to continue to be for a long time.

Mark R. Altschwager

Analyst, Robert W. Baird & Co., Inc.

Q

That's great. Thanks for taking my questions.

Operator: Our next question comes from Irene Nattel of RBC Capital Markets.

Irene Nattel

Analyst, RBC Capital Markets

Q

Thanks and good morning everyone and Happy New Year. Obviously, great quarter, really intrigued by some of the commentary around the success of – if you will, extended product offering. And I think in your closing remarks, Brian, you mentioned something about a sizing initiative. So wondering if you could kind of talk a little bit about what might be coming and perhaps sizing men's, warm weather, the evening collection kind of what's behind that thinking?

Brian Hill

Founder, Chief Executive Officer & Chairman, Aritzia, Inc.

A

I'm just going to make a note of a few of these things, sizing, warm weather...

Irene Nattel

Analyst, RBC Capital Markets

Q

Men's, warm weather, the evening collection of Babaton, which by the way is all really exciting.

Brian Hill

Founder, Chief Executive Officer & Chairman, Aritzia, Inc.

A

Okay, I'm going to go in reverse order here. So one of the opportunities – Happy New Year, Irene.

Irene Nattel

Analyst, RBC Capital Markets

Q

Thanks, Brian.

Brian Hill

Founder, Chief Executive Officer & Chairman, Aritzia, Inc.

A

One of the opportunities we found is that we've had a lot of everyday luxury and we have a bit of joke internally, we need a little bit of every night luxury as well. And so we think we have some opportunities here with a little bit more body conscious, form fitting clothing for women, so that we're not just supplying all our clothes during the day and on the weekends and things, but a little bit more effort than going out at night. So we launched TEN by

Babaton, it has been our most successful launch to date. We're super excited about it and we're going to be expanding that meaningfully.

As far as the men's go, we're doing such a great job and we're getting so many calls and we started seeing a lot of men wear our ladies super tops last year. So we expanded into it. We took it pretty – it certainly wasn't a conservative position. It was – I would argue a bit of an aggressive position, and as I mentioned, we sold out for all intents and purposes. We didn't quite get the sizing right. The fit was excellent, but we didn't get the sizing right. We probably bought a little bit too many and some larger sizes. So we have a few XLs and XXLs hanging around, but the smalls and medium sold out almost immediately and we're going to expand into that. We were shocked at the response we received. I don't know, Irene, if you saw, you didn't mention anything about our dog initiative as well, but we've had a lot of social...

[indiscernible] (00:31:11)

Irene Nattel

Analyst, RBC Capital Markets

Sorry, not a dog owner.

Q

Brian Hill

Founder, Chief Executive Officer & Chairman, Aritzia, Inc.

Yeah, we launched the Ruff Puff as a little bit of a fun thing to do while we're at it and send them out to celebrities and people like that and we actually sold out. And I think it was our – was it our highest...

A

Jennifer Wong

President, Chief Operating Officer, Corporate Secretary & Director, Aritzia, Inc.

Number two engaged social media post.

A

Brian Hill

Founder, Chief Executive Officer & Chairman, Aritzia, Inc.

It was our number two engaged social media posts with our Ruff Puff initiative. So...

A

Jennifer Wong

President, Chief Operating Officer, Corporate Secretary & Director, Aritzia, Inc.

After Meghan Markle on the cocoon coat.

A

Brian Hill

Founder, Chief Executive Officer & Chairman, Aritzia, Inc.

After Meghan Markle on the cocoon coat last year. So, we had some fun with that. As far as sizing goes, I mean, there has been a push into more inclusivity obviously throughout society and certainly in the fashion business and that's not lost on us. And one of our designers is quite passionate about it. So we're launching a initiative. Presently, we do have – our core sizes go up to 10 but we obviously do carry size 12. I believe we're going up to size 18 with this initiative. We're testing it in Babaton and we'll see how our customers respond to it.

A

So we're excited about that. We're not sure it's going to make a meaningful impact to our sales, but we think it's the right thing to do for our customers. And then warm weather, as we continue to push into the United States, we're pushing into Texas, we're going to be pushing into more southern states, as I mentioned, California and Los

Angeles specifically. We have a bit of a push going on there and so these are all warm weather environments and we need to make sure our collections, particularly, our fall and winter collections obviously, our spring and summer are suitable, but our fall and winter collections, which are typically made up by sweaters and outerwear and things, we need to make sure we have the right offering there. And I think, right now, our offerings are not reflective entirely. And I think it's an opportunity for us and to be able to grow the collection such to appeal to these customer groups in these warmer weather markets in the fall and winter.

Irene Nattel

Analyst, RBC Capital Markets

Q

That's great and just one more. Thank you. I really appreciate that and one more, if I may. Obviously, e-commerce is a word that you – that's mentioned a lot in the press release, you mentioned a lot in the call, significant growth, I think it's a terminology that you're using. Would you care to let us know what the current penetration is on e-commerce?

Brian Hill

Founder, Chief Executive Officer & Chairman, Aritzia, Inc.

A

I don't – it's really hard to figure out the exact numbers because we have a lot of omni going on and a lot of product [indiscernible] (00:33:52) was bought online and returned to stores and we have a lot of activity in the stores. It's purchased online and it's hard to sort of figure these out with all our new systems and things we're putting in. We'll be able to get some numbers on [indiscernible] (00:34:08), but I'm not sure at this point in time, we share those numbers at this point in time because – and we don't even really look at them specifically like that and – but as we continue, unfortunately, it's now beginning to get even more confusing as we continue with our omni initiatives going forward. But all I can suggest is that we're on track for all our numbers as far as e-commerce goes and if not exceeding them.

Irene Nattel

Analyst, RBC Capital Markets

Q

That's great. Thank you.

Operator: Our next question comes from Derek Dley of Canaccord Genuity.

Derek Dley

Analyst, Canaccord Genuity Corp.

Q

Yeah. Hi. I'm just wondering if you could help us out in terms of quantifying the magnitude of some of the impacts on the gross margin. Todd, you mentioned that you expect raw materials to be up in Q4 and some incremental costs associated with tariffs but I guess the one that was more confusing to me was just that the distribution center cost. Should we think of that as one timing in Q3 or can you kind of just give us a pecking order of what impacted the gross margin the most in Q3?

Todd Ingledew

Chief Financial Officer, Aritzia, Inc.

A

Yeah. I would consider the distribution center onetime in Q3 that again was in preparation for the holiday season this year. We hired up our seasonal staff earlier than in the prior year to ensure that everybody was trained and that we were running smoothly for holiday, but that will not happen obviously in Q4. And we don't quantify the particular pressures but as I said, we expect similar pressure on gross profit as we saw in Q3.

Brian Hill

Founder, Chief Executive Officer & Chairman, Aritzia, Inc.

And if I could add, I thought this initiative of hiring early of other teams is an incredible job. We had our best teams we've ever had, leading into the holiday season and we managed to be able to – we saw very effective ship through and turn rates even through the busiest periods here through e-commerce, Black Friday and Cyber Monday and things. And so the initiative worked out extremely well as you can see from our numbers and so we're super excited with the initiative this year and we plan on doing the similar initiative next year.

Derek Dley

Analyst, Canaccord Genuity Corp.

Okay, great. That's very helpful. Just shifting gears a bit, just in terms of your balance sheet obviously, very healthy area in the net cash position, can you talk about some of your capital allocation priorities over the next year or two?

Todd Ingledew

Chief Financial Officer, Aritzia, Inc.

We obviously were very pleased to see the growth in our cash balance again and the growth in our business is, always as we said, our primary focus and the primary use of our cash. We do have NCIB in place. We'll be purchasing through that opportunistically and reviewing other alternatives, including paying down our term loan potentially at some point. But we just now returned to a strong cash position and we'll be reviewing our options over the next several quarters.

Derek Dley

Analyst, Canaccord Genuity Corp.

And what about the potential implementation of a dividend, is that something that you'll be discussing at the board level in the future?

Todd Ingledew

Chief Financial Officer, Aritzia, Inc.

It's obviously one of the things on the menu for capital allocation. We have not begun discussions on that, in particular, right now.

Derek Dley

Analyst, Canaccord Genuity Corp.

Okay, great. Thank you very much.

Operator: Our next question comes from Mark Petrie of CIBC.

Mark Petrie

Analyst, CIBC World Markets, Inc.

Hey, good morning. Brian, just given the importance of the US in terms of current performance but also future growth and could you just give us a little bit more detail in terms of the performance in your newer markets versus more established markets and then any metrics or sense in terms of just the sales results beyond in terms of progression on building the brand and brand awareness?

Brian Hill

Founder, Chief Executive Officer & Chairman, Aritzia, Inc.

A

We're seeing strength in both markets. The last two stores we opened in Cherry Creek and in Denver and Mall of America in Minneapolis both exceeded our expectations. We've seen e-commerce growth in both those markets double, more or less double, last I checked since we opened in both of them. And this is a trend we're seeing in United States is store openings being extremely successful and then e-commerce growing along with that at a meaningful clip.

So we're super excited about that. But we continue to see growth in our US and our US comps. Quite frankly our US comps seem to be – are very healthy. And so we're seeing mature markets in the US continue momentum as well. So we're just really excited about our United States business and the opportunity ahead of us because really our penetration is so small there right now that we just have -big opportunities can keep us busy for some time here.

Mark Petrie

Analyst, CIBC World Markets, Inc.

Q

And you've talked about sort of the enhanced social media programs, increased use of influencers and celebrities. Could you please give a bit more detail just in terms of the response from that strategy, how you're sort of looking at the returns from this? And then, I guess, more broadly, how you sort of think about differentiating in an increasingly sort of noisy sort of social media marketing space?

Brian Hill

Founder, Chief Executive Officer & Chairman, Aritzia, Inc.

A

The social media, thanks for that. The social media market is not increased, just increasing, noisy as you mentioned. But the landscape's changing a little bit as well and obviously we've done a great job with the macro influencers. We've done a great job with the unpaid influencers. We have some opportunity certainly in the micro influencers. And I don't think we've really gotten going there yet but we plan on going there. But there's some – there's various data that would suggest that the landscape is changing with the influencers as well. And so everything's happening in a lot faster pace. And we've kept up and the initiatives that we've done to date have been extremely successful. It's certainly helped drive our outerwear program this past season, we invested heavier in that. I don't know if you saw a recent post by Kris Jenner who posted on her website an incredible – we did a favor for them and for the Jenners and Kardashians, and we've created all their Christmas gift packaging and things that were large versions of our Aritzia packaging, eCommerce packaging and she was posting, I think she got 33 million followers and we did that and she posted [indiscernible] (00:41:21) January...

Todd Ingledew

Chief Financial Officer, Aritzia, Inc.

A

December 31.

Brian Hill

Founder, Chief Executive Officer & Chairman, Aritzia, Inc.

A

...December 31, you want to check that out. So we have relationships with various social media and important social media players and it's working well for our business and so we're going to continue to pursue that. We're not a social media-led marketing organization. We'd like to think we're a product and boutique and eCommerce and customer service-led organization, but certainly working with social media and social media players certainly enhances the recognition of our product and our services in United States, particularly.

Mark Petrie

Analyst, CIBC World Markets, Inc.

Q

Okay. Thanks. And, yes, I did see that post and I think my Instagram algorithm is increasingly confused by all of my searches. But, Jen, you highlighted the recent additions in different sort of areas of the organization, they sound like areas that you're going to sort of want to continue to invest, is that a fair assumption? And do you think that that ramps from what we've seen in the last year or so, or is this sort of steady state?

Jennifer Wong

President, Chief Operating Officer, Corporate Secretary & Director, Aritzia, Inc.

A

We will continue to invest in enabling our growth over the coming years and as you know, we always invest with the long-term in mind. So certainly, across technology and talent, as I talked about earlier, we will continue on that trend for sure.

Mark Petrie

Analyst, CIBC World Markets, Inc.

Q

Okay. And then, I guess, just related to that, just sort of being more specific, Todd, you highlighted that excluding the IT platform investment in Q3, you would've seen positive SG&A leverage of 30 basis points. We know that continues in Q4, how should we think about that type of spending for fiscal 2021?

Todd Ingledew

Chief Financial Officer, Aritzia, Inc.

A

We'll be providing our fiscal 2021 plan in May. So, at that point, we'll get into specifics, but as Jennifer just said, we're continuing to invest today and we'll do so in the future.

Mark Petrie

Analyst, CIBC World Markets, Inc.

Q

Okay. Thanks. All the best.

Jennifer Wong

President, Chief Operating Officer, Corporate Secretary & Director, Aritzia, Inc.

A

Thanks, Mark.

Operator: Our next question comes from Brian Morrison of TD Securities.

Brian Morrison

Analyst, TD Securities, Inc.

Q

Hi. Good morning. If I can just go back to the success of the men's platform that you were talking about, I realized it's small potatoes at this point in time. But if you could just go through the thought process of further expanding that portfolio and potentially, it's unfair at this time. But maybe your initial thoughts on long term, if this is going to be a material growth angle for the company?

Brian Hill

Founder, Chief Executive Officer & Chairman, Aritzia, Inc.

A

Yeah. It's actually, we kind of joke about it internally, because when we first did our partnership with Berkshire almost 15 years ago, Kevin Callaghan, the senior partner of Berkshire mentioned men's to the press and they

jumped all over it. And so we've been teasing him about that ever since and so he was the most excited when we actually did launch this outerwear program because he said I knew this was going to happen sooner or later. So 15 years later and so he's finally being proven correct.

We had a great product and we decided to leverage that into the men's product. I was particularly passionate about it myself. I don't know if you have one. I'd like to get you one if we're not sold out. But I've been wearing mine and I absolutely love it and all the feedback has been extremely positive. We're expanding that program specifically within that program though for next season and maybe look to outerwear, I mean, obviously, getting into the men's business, certainly in our stores changed that dynamic in our store and we recognized that. We have fitting rooms that women feel comfortable in that primarily men are excluded from typically and those dynamics that get changed in the stores and retail.

Obviously, from an eCommerce perspective, it's easier to get in the men's, but we're just – we are cognizant that it would change the dynamics in our stores, if we start having men's product in there when people, particularly product, that would have to start changing our fit rooms.

In addition to that, we have such a great opportunity with our logistics just continuing to grow our footprint in the United States, both online and physically and so it's really something. It's certainly a lot simpler business for us is to continue to push and where we are. Obviously, it's fun to men's business. It's been incredibly successful, but we need to keep our feet on the ground here. We are a women's clothing retailer; and until further notice, we'll continue to be a women's clothing retailer. So the men's is fun and extremely profitable pursued in the short term, and we're certainly discussing the opportunity. And perhaps as eCommerce continues to grow, we would start with maybe introducing a few more products for men in our eCommerce, and then consider, I guess, at some point in time some more physical stores, but truthfully this is far off right now in our thinking and certainly not our priority right now.

Brian Morrison

Analyst, TD Securities, Inc.

Q

Okay. That's – I appreciate the details. Maybe, Todd, turning back to the balance sheet, I heard the response to the earlier question, in terms of allocation of capital, maybe you can just address on a pre-IFRS 16 basis, what you think the appropriate leverage is for your company?

Todd Ingledew

Chief Financial Officer, Aritzia, Inc.

A

Well, Right now we're by about 0.5 and I think we have always discussed maintaining a low leverage due to good flexibility that provides and it's not uncommon for retail companies to have zero debt. And so I'm not sure that obviously we could manage and would be comfortable with a higher level of debt if we had requirements for that debt, but we don't have the need today. So I don't know if that answers your question but I would say on a steady-state basis business as usual that we would likely look at paying the debt down at some point in the future, just as opposed to having it sitting on the balance sheet or in cash. And so again if we have requirements for debt at some point in the future, we feel like our business could manage a much higher turn than we have today, but we don't have any need for it at this point.

Brian Morrison

Analyst, TD Securities, Inc.

Q

Okay. I think that seems very conservative. Okay, last question, I apologize, this is bit of a housekeeping question but at the CAD 7 million to CAD 8 million strategic spend that you have going on this year, flowing through your income statement, maybe just elaborate what you think is recurring for next year?

Brian Hill

Founder, Chief Executive Officer & Chairman, Aritzia, Inc.

A

So, the CAD 7 million to CAD 8 million is the beginning of the first in part of all four of those projects and the digital selling tools is really getting kicked off in earnest right now. So that will continue into next year, some new spend on that project, as well as the future phases of really the other three as we ramp them up. And we don't expect the spend to be in the magnitude of CAD 7 million to CAD 8 million for next year, but there still there will be somewhat material spend or investment that will continue into next year.

Brian Morrison

Analyst, TD Securities, Inc.

Q

Thank you very much.

Operator: [Operator Instructions] Our next question comes from Stephen MacLeod of BMO Capital Markets.

Stephen MacLeod

Analyst, BMO Capital Markets (Canada)

Q

Thank you. Good morning and Happy New Year. Lots of great color on the call so far and many of my questions have been answered, but I just wanted to follow-up on two things. Specifically on the gross margin, you've talked about the raw material pressure that crept into the back half of the year, Q3, Q4 of the fiscal year. Historically, you've had pretty good visibility into your raw material cost and I'm just curious when do you expect to sort of cycle through that escalating or inflated raw material portion on the gross margin side?

Brian Hill

Founder, Chief Executive Officer & Chairman, Aritzia, Inc.

A

We don't have a crystal ball and so we don't – can't really predict what's going to happen with raw material prices at this point. We do know that we continue to provide high-quality fabrics and construction on our products, and so we are a little bit at the mercy to some of these external pressures. We have no idea when some of these pressures particularly enrolls and things are going to subside. I can't recall, but a large percentage of [indiscernible] (00:50:50) comes from Australia and what's going on down there is certainly of concern far beyond our industry for sure.

But we've also had a little bit of pressure on initiatives that we're taking to improve various trims and construction and things like that, and so a little bit of it is, as I mentioned, majority's external, but a little bit of it is self-imposed. We just really want to continue to grow and improve our product and so we're going to continue to do that, and we're apprehensive that on certainly a lot of our carryover products to pass on and these increases to our customers. We want our customers used to paying certain prices for things. So, we want to continue to do so and we have an extremely successful and profitable business.

So, at this point in time, you don't see any need to increase the prices of our products to reflect these. We're hesitant because we don't want to lose our momentum and the great momentum and opportunities we have going forward. So we're pretty unfortunately as these things happen. We have to roll with it, but as we mentioned we knew this was coming. We saw this happening and we're going to continue to make sure that first and foremost,

our product and product pricing to our consumer makes sense to them and is palatable to the customer and they're excited about our product and our pricing and then we'll figure out what's going to happen externally.

Stephen MacLeod

Analyst, BMO Capital Markets (Canada)

Q

Right. Okay. That's helpful. Thank you. I don't know if you mentioned, if you did, I apologize. But did you mention a total US revenue growth number and if not is that a number that you can provide -it's the number you've provided in past calls?

Brian Hill

Founder, Chief Executive Officer & Chairman, Aritzia, Inc.

A

Yeah. In the statements, it's 27.6% in the quarter was our US growth.

Stephen MacLeod

Analyst, BMO Capital Markets (Canada)

Q

Okay.

Brian Hill

Founder, Chief Executive Officer & Chairman, Aritzia, Inc.

A

So, [indiscernible] (00:52:53) a little bit from the second quarter.

Stephen MacLeod

Analyst, BMO Capital Markets (Canada)

Q

Okay, great. Thank you. And then maybe just finally, Jennifer, you provided some color around the new Customer Program implementation and the PLM program. Can just remind us where that sits in terms of the broader sort of SAP initiatives that you announced in, I believe, it was Q1?

Jennifer Wong

President, Chief Operating Officer, Corporate Secretary & Director, Aritzia, Inc.

A

The PLM is not part of the SAP partnership. The PLM is a standalone solution that supports the product processes, so that's not part of it. The SAP partnership that we had announced a couple of quarters ago, involved the Customer Program which is a program of four specific projects, two of which went live last quarter and one of which should go live in Q1 of 2021. And then the digital sign tool which is the one we're very, very excited about because it will leverage all of what we've put in the three before that we've put in that the first phase of that should go live in the summer of calendar 2020.

Stephen MacLeod

Analyst, BMO Capital Markets (Canada)

Q

Okay. That's great. Okay. Thank you very much.

Helen Kelly

Vice President-Investor Relations, Aritzia, Inc.

A

Thanks, Steve.

Operator: This concludes the question-and-answer session. I'd like to turn the conference back over to Ms. Kelly for any closing remarks.

Helen Kelly

Vice President-Investor Relations, Aritzia, Inc.

Thank you, Ariel. And thanks again to everyone for joining us this morning. The team and I will be available later to answer any additional questions you may have. We look forward to speaking with you again soon. Thank you.

Operator: This concludes today's conference call. You may disconnect your lines. Thank you for participating and have a pleasant day.

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